Mark's Musings

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Going to the candidates' debate

Laugh about it, shout about it

When you've got to choose

Ev'ry way you look at it, you lose

- Simon and Garfunkel

What Trump Means for Your Financial Future

Executive Summary

- To date, asset markets on the whole appear to have embraced the narrative that Trump's platform of tax cuts, deregulation and infrastructure spending will unleash a resurgence in economic growth in the US and by extension a renewed bull market in risk assets. Such optimism has been further reinforced by the growing comparisons between Donald Trump and Ronald Reagan, whose presidency ushered in the greatest bull market in US history.

- On the surface, such comparisons may seem apt; however, a more careful examination uncovers stark and important differences — both between the two as individuals but, more importantly, between the economic and financial circumstances they inherited at the start of their respective presidencies. It is these differences that reveal the fallacy of thinking we are on the verge of a robust and sustained bull market in risk assets.

- At present, the market appears to be discounting all of the potential positives of a Trump presidency while ignoring any potential negatives. We think the market is failing to price in the inherent uncertainties of a Trump presidency, most particularly potential economic and geopolitical conflict, as well as the possibility of a severe financial unwinding.

- In such an environment, portfolio diversification and eschewing richly priced risk assets is prudent. Investors would do well to evaluate their portfolios to ensure they are prepared for the potential downside risks the future may present.

"There are three classes of people: those who see, those who see when they are shown, those who do not see."

Leonardo Da Vinci

"There are people who think of [him] as a clown and a buffoon. But I do not. I despise [him] and everything that [he] has come to stand for. I think if [he] were a paid [enemy of the state] he could not do more to harm this country than he's doing now."

Sen. Thomas Jordan, The Manchurian Candidate (1962)

As I pen this, the Dow, S&P 500 and Nasdaq are all reaching all-time intraday highs, and we are now three weeks into Donald Trump's presidency. This has been the most challenging quarterly report I have written for a couple of reasons. First, while I have very strong feelings about the behavior of Donald Trump, I believe the level of rancor and *ad hominem* attacks leveled by the right and the left towards each other are making matters much worse. Therefore, I will endeavor to bluntly assess the specific concerns I have for financial markets due to Trump's victory while trying to refrain from engaging in ideological polemics. Second, forecasting future events concerning asset markets is hard enough, but it becomes even more nettlesome when the least predictable person ever to occupy the White House is now president. But, as will become evident, Trump's unpredictability in itself is a very critical bit of information to use in constructing an investment strategy going forward.

While asset markets to date have been buoyed by the prospects for a Trump presidency, initially it was a rocky relationship. After major media outlets had called the race for Trump, but before his acceptance speech, stock markets plunged (S&P futures were down an astonishing 6%), bonds prices soared as investors sent hundreds of billions of dollars into safe havens, and the US dollar fell sharply. How anomalous were these moves in asset prices? According to the Bank for International Settlements' year-end report, the magnitude of asset price movements in the wake of Donald Trump's victory was a five standard deviation event. In other words, such a massive movement down in asset prices would be expected to occur roughly once every 13,500 years.

Even more remarkable than the level of global panic that gripped investors in the couple of hours after it became evident that Donald Trump would become the United States' next president was the rebound that ensued the following day. The S&P 500 was up more than a percent as markets opened on November 9th, making the bottom to top move approximately 7% in a mere ten hours. Since Trump's victory, the US stock market has seen its strongest post-election rally since Herbert Hoover won the presidency in 1928. Markets, it would seem, have wholeheartedly embraced the narrative that Trump's agenda of lowering taxes, cutting regulations and boosting infrastructure spending will be great news for both the economy and asset markets.

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I. Nine Reasons Why Donald Trump is No Ronald Reagan

Adding to the level of market euphoria surrounding Trump are the comparisons of him to Ronald Reagan, whose presidency ushered in the greatest US bull market in history. Superficially the comparison seems to be an

> *"... it is in these differences [between Trump and Reagan] that the fallacy of expecting a Trump presidency to usher in another multi-year roaring bull market becomes evident."*

apt one. Both men were media sensations lacking in the traditional background for politicians. Reagan and Trump embraced their status as political outsiders and iconoclasts. Both men were seventy during their first year in the White House. They also shared the belief that lower taxes and fewer regulations would help unleash economic dynamism. Finally, they both railed against what they saw as the liberal status quo and promised to make America a far better, more respected and more powerful nation. However, I would argue that once one digs beneath the surface, the ostensible similarities between the two men disappear, leaving their differences in stark relief. And, I contend, it is in these differences that the fallacy of expecting a Trump presidency to usher in another multi-year roaring bull market becomes evident.

The differences, as I see them, between Trump and Reagan can be broadly grouped into three categories: those which emanate from the financial and economic circumstances they inherited at the beginning of their presidencies, those which result from their policy prescriptions, and those which stem from their personal leadership styles and characteristics. I recognize that a negative assessment of his leadership qualities and personal behaviors can run the risk of being construed as a personal indictment of Trump. Let me reiterate that this is not my intention. I explore these issues not to develop an *ad hominem* critique but rather in an attempt to objectively identify behavioral manifestations for the primary purpose of assessing their likely impact on financial markets going forward. By way of full disclosure, I did not vote for either major party candidate in the 2016 US election; however, I did find the prospect of a Trump presidency to be particularly unpalatable.

In the following sub-sections, I offer a rather detailed examination of the key differences I see between the two presidents and the economic circumstances they each inherited, hoping to elucidate the likely implications for asset markets. Readers feeling particularly bogged down by this level of analysis or who wish to focus their attention on its practical applications, may wish to skip ahead to the next major section, "What is an Investor to Do?" (beginning on page 11), which deals with the investment implications of these distinctions.

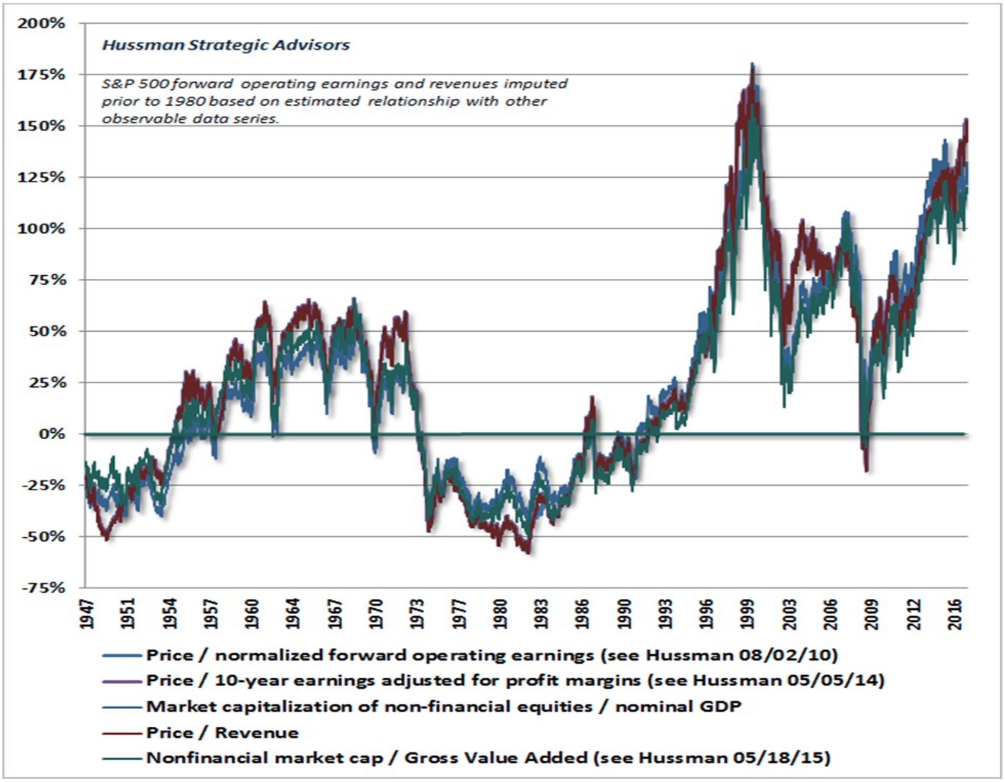
1. Market Valuations are Opposite from One Another

When Ronald Reagan became president, US equity markets had endured a wrenching thirteen-year bear market during which the S&P 500 declined more than 50% on an inflation-adjusted basis. The price-earnings (PE) ratio for US stocks was 7.5, or approximately ½ of its median level of 14.65 over the last 145 years. Stocks were thus historically very, very cheap. The only time they had been that inexpensive in the prior fifty years was 1949. As I have argued in previous reports, the vast majority of longer-term (10-12 year) returns for stocks is predicated on valuation. Thus, the tremendous bull market that started in 1982 from these depressed valuations should have come as no surprise to the historically informed, value-conscious investor.

Presently the US market has a PE ratio greater than 25, or nearing twice its median level. Indeed this is the second most overvalued stock market since the Great Depression, exceeded only by levels attained during the dotcom bubble era. The median stock has actually never been this overvalued, as large-cap stocks were responsible for the vast majority of the overvaluation during the 1997-2000 bubble. Exhibit 1, below, from Hussman Strategic Advisors, provides a compelling summation of the extreme valuation levels we currently witness in the S&P 500 and how they compare to the bargain basement levels seen in the early 1980's. The exhibit presents several valuation measures that Hussman Strategic Advisors has found to be most strongly correlated with subsequent S&P 500 total returns over a 12-year period. The measures are shown as percentage deviations from their historical norms.

In sum, depending on the specific valuation metrics one chooses, US stocks are some-

Exhibit 1. S&P 500 Market Valuation Measures (percent deviation from historical norms)



Source: Hussman Strategic Advisors

where between three and five times more expensive than they were when Reagan took office. Precisely the opposite price levels from which one would expect even decent, much less robust, longer-term gains.

2. As are Bond Prices

Ronald Reagan did not just have the good fortune of inheriting a very cheap stock market. Bond prices had also experienced a bear market that had lasted for more than twenty-five years. US ten-year Treasury yields had skyrocketed 440% from a paltry 2.29% in April 1954 to almost 13% by the time Reagan took office. And while ten-year Treasury yields would eventually peak another 250 basis points higher before the end of 1981, there would be plenty of room for rates to go down over the course of Reagan's two terms in office. By the time George HW Bush succeeded Reagan, ten-year Treasury yields had fallen more than 620 basis points from their peak. The ability to lower interest rates under Reagan would prove to be critical in underpinning the economic and financial revival in the US during his term of office. Substantially lower interest rates reduced the cost of capital for both US consumers and corporations. This spurred domestic investment and a much greater array of projects now penciled out as profitable than was the case during the era of double-digit interest rates.

Donald Trump is inheriting a vastly different bond market. While one cannot be certain, we may have seen the end of the thirty-five-year bond bull market in early July, when ten-year US Treasuries hit a record low yield of 1.375%. But this paltry figure seemed almost exorbitant when compared to select 10-year foreign sovereign bonds, several of which were trading with negative yields. Negative ten-year sovereign bond yields meant one had to **pay** for the privilege of loaning money

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Exhibit 2. Starting from Opposite Sides: Key Economic and Financial Statistics, 1982 and 2016

	1982	Today		1982	Today
Federal Funds Rate	18.00%	0.50%	**Annual Inflation Rate (CPI)**	8.00%	1.60%
10-Year US Treasury Yield	15.00%	2.30%	**Personal Savings Rate**	10.00%	5.00%
Mortgage Rate	16.25%	3.87%	**Labor Force Participation**	64.00%	63.00%
Household Debt to Income	62.00%	130.00%	**S&P 500 - CAPE**	7x	26x
US Government Debt to GDP	30.00%	105.00%	**S&P 500 Median Price to Sales**	0.50x	2.20x
Total US Debt to GDP	0.90x	3.60x	**Median Age Baby Boomers**	26	60
Productivity Growth	2.00%	0.25%	**Global Trade Barriers**	Falling	Rising

Sources: Lance Roberts, Chief Portfolio Strategist, Clarity Financial; Marc Faber, The Gloom, Boom & Doom Report.

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to a variety of governments for a full decade! Not only did interest rates rise from their early summer lows leading up to the US election, but ten-year US Treasury yields are up 30% in just the three months since Trump's victory. This is largely based upon expectations that more robust economic activity will cause inflationary concerns and that higher expected deficits under Trump will put upward pressure on interest rates. I do not rule out the possibility that in the near-term interest rates may have overshot as a result of overly roseate expectations of future economic activity. However, one can say that it is extremely likely that over the next four years, Trump will be steering an economic vessel facing interest rate headwinds as opposed to tailwinds. After the thirty-five-year bull market in interest rates, there is little practical room for rates to fall. While a 600+ basis point decrease in interest rates on ten-year Treasuries under Reagan still left those rates in the high single digits, with a commensurate decrease today, these bonds would have to sport a yield of negative 3.5%. Indeed the only scenario in which one would expect interest rates to fall even one-percent is one in which the world economy has plunged into a recession, in which case falling rates would hardly be welcome news for most investors.

3. Where Have You Gone, Paul Volker?

While most value-conscious investors with a solid knowledge of market history are well-aware of the first two distinctions, this third distinction is often not given the importance I think is deserves. Ronald Reagan had the good fortune of being the beneficiary of one of Jimmy Carter's best decisions — selecting Paul Volker to be chairman of the Federal Reserve in 1979. I believe Volker was the last great, or even competent, chairman of the Fed. Volker fully understood that his primary job was to crush the back of inflation, which by 1979 had spiraled to 15% per annum. Despite the US having endured a historically very weak economy throughout most of the 1970's, Volker advocated the need for the US economy to take the medicine necessary to rid it of pernicious inflation through the dramatic hiking of interest rates. Reagan bitterly opposed this course of action as it largely caused what at the time was the worst economic recession since the Great Depression. Nevertheless, Reagan and the country reaped the benefits of inflation declining by more than 70% over the next five years.

Janet Yellen and her bumbling predecessors have manifested the opposite characteristics that made Volker so effective. Far from taking away the punch bowl (what responsible central bankers should feel compelled to do), Greenspan, Bernanke and now Yellen have expressly tied their policies concerning interest rates to how favorably they are received by financial markets in general, and Wall Street in particular. Their champions point out that with muted headline inflation over the last thirty years, they have been able to deftly keep interest rates low so as to foster the greatest amount of economic and financial activity. But this conveniently leaves out the fact that consumer inflation is not the only kind of deleterious inflation. The kind of extreme asset price inflation that we saw leading up to 2000, 2007, and, I would argue, the present leads to massive income and wealth inequalities (one of the main reasons his supporters viewed Trump as an attractive candidate). Asset bubbles also foster malinvestment and lead to the inevitable and devastating economic consequences of the crashes that ensue. Finally, I would point out that by keeping interest rates artificially low for over fifteen years now, this has amounted to a massive transfer of wealth from savers (many of very modest means on fixed incomes) to profligate borrowers.

4. The Mountain of Debt

When Reagan took office, the national debt was a relatively paltry $900 billion, which was roughly 30% of GDP. Today the national debt has skyrocketed to nearly $20 trillion, comprising well over 100% of our GDP. Personal consumer and mortgage indebtedness from 1981 to present has outpaced economic growth by a factor of two, rising 1,100% compared to 550% GDP growth. Meanwhile, corporate debt has risen by approximately 1,200% since the beginning of 1981.

So, unlike Reagan, who could pursue expansionary fiscal policies without being concerned about reaching anything approaching perilous debt levels, if Trump does the same thing we could see debt-to-GDP levels increase another 20% or more in his first term. The Congressional Budget Office is projecting the national debt to approach $30 trillion in the next ten years, or nearly $250,000 per taxpayer. And this could be conservative depending upon the success Trump has with cutting taxes and increasing spending on everything from infrastructure to the military. In short, Trump appears to have far less leeway when it comes to fiscal policy and debt dynamics. Early indications from the fiscally conservative members of Congress support this view, calling into question the extent to which Trump can rely on expanding fiscal deficits in an attempt to boost economic growth.

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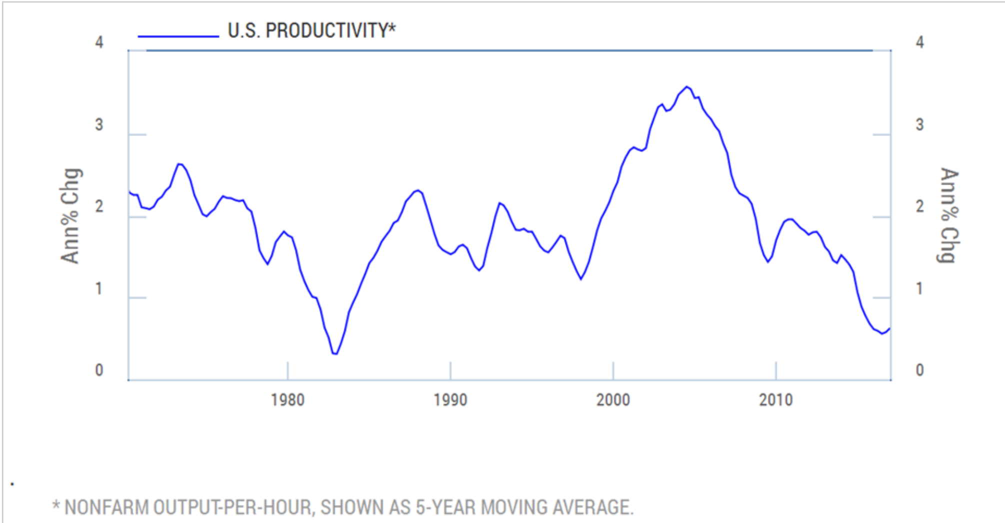
5. A Productivity Drought

When Reagan became president, unemployment was 7.5% and rising. Moreover, early on in Reagan's first term, interest rates peaked and began a multi-decade decline to the levels we have today. The combination of economic slack (spare human and physical capital businesses could readily deploy) and a declining cost of capital fostered the kind of business investment that drove productivity higher throughout most of the 1980s compared to the relatively moribund productivity growth in the 1970's (*see* Exhibit 3).

The economy Trump inherits is quite different. Unemployment is below 5% and is at its lowest level since before the Global Financial Crisis (GFC). As noted above, there is scant hope that interest rates have any substantial room to move down, which could provide a tailwind for domestic investment and capital deepening — the necessary antecedents for a

Exhibit 3. United States Productivity Growth (annual percent change, shown as 5-year moving average)



Source: BCA Research, Inc.

"… while corporations piled on record amounts of debt when interest rates hovered near record lows, precious little of this new capital was directed toward business investment."

structural rise in productivity. It is most telling that while corporations piled on record amounts of debt when interest rates hovered near record lows, precious little of this new capital was directed toward business investment. Between the 3rd quarter of 2015 and the 3rd quarter of 2016, gross fixed capital formation (a metric to measure what level of US wealth creation is invested versus consumed) actually *declined* 0.5%. Given the fact that the vast majority of money borrowed and earnings created by corporations are not invested back into the companies but are rather used for a record level of stock buybacks, as well as dividend payouts, acquisitions and mergers, this should not come as a surprise. All of these activities merely divide up pre-existing corporate wealth differently (financial alchemy). They do not enhance the ability of businesses to generate *more* wealth.

6. Openness to Cross-Border Flows of Goods and People

This might be the single greatest distinction between Reagan and Trump. In the tradition of classically Liberal economic thinking (e.g., that of Adam Smith and David Ricardo), Reagan was a strong proponent of both free trade and relatively open immigration. In 1986 Reagan opined, "Our trade policy rests firmly on the foundation of free and open markets. I recognize … the inescapable conclusion that all of history has taught: The freer the flow of world trade, the stronger the tides of human progress and peace among nations." Reagan also had the good fortune of taking office shortly after Deng Xiaoping became the principle leader in China and began the process of embracing capitalism and international trade. This would be a critical development in the advancement of economic globalization.

Unlike most American conservatives in the last forty years, Reagan largely embraced immigration as well. The Immigration Reform and Control Act of 1986 legalized 2.8 million undocumented workers. In fact, more legal immigrants entered the US during his presidency than at any time since the earliest years of the 20th century.

Trump has obviously made it the very cornerstone of his presidency to oppose both free trade and immigration, legal or illegal.

Steve Bannon, Trump's chief strategist, has declared himself an "economic nationalist" and has vociferously denounced globalization and free trade as being inimical to the interests of US citizens. Bannon and Trump have taken particular aim at NAFTA, citing it as the reason the US has lost millions of jobs in manufacturing. This claim is specious at best. According to the Bureau of Labor Statistics manufacturing as a percentage of nonfarm payrolls stood at about 33% in 1953. During the next fifty-five years, this percentage dropped remarkably consistently, declining an average of 2.3% per year until manufacturing as a percentage of nonfarm payrolls dipped to 9% in 2008. Critically, the pace of decline *did not* increase at all after NAFTA took effect in 1994 (*see* Exhibit 4). Strong secular changes in the level of US manufacturing employment were clearly responsible for all, or nearly all, of the decline in US jobs that Bannon and Trump try to blame on free-trade agreements such as NAFTA.

Whatever economic benefits a Trump presidency may have due to deregulation and lower taxes could be entirely offset (and possibly more than offset) by his trade and immigration policies that are informed by a fundamentally flawed set of assumptions. Trump has repeatedly manifested a remarkably binary view of the world during his entire public adult life. People are either his supporters or his enemies; news is either favorable, and hence accurate, or unfavorable, and thus must be "fake;" organizations are either amazing or terrible; people who agree with him are smart, while those who have the temerity to take issue with him, such as Washington federal court judge James Robart, must be dumber than a "bad high school student;"[1] finally, and most germane, a negotiation or

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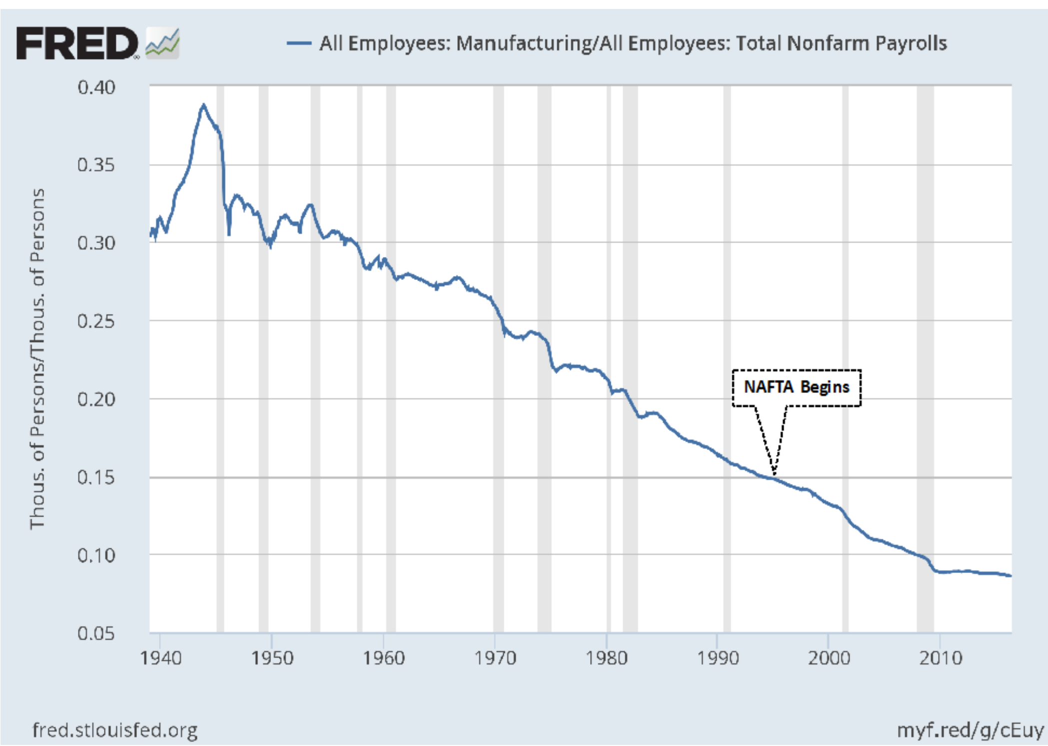
Exhibit 4. US Manufacturing Employment as a Percent of Total Nonfarm Employment



Sources: Saint Louis Federal Reserve Bank; US Bureau of Labor Statistics.

[1] Although a Ninth Circuit panel just unanimously took issue with this assessment, upholding Judge Robart's stay of Trump's executive order temporarily banning travel from seven predominantly Muslim countries.

"Trump has repeatedly manifested a remarkably binary view of the world … a negotiation or deal involves a "winner" and a "loser." This ... is of critical importance. It assumes we live in a zero-sum world."

deal involves a "winner" and a "loser." This last point is of critical importance. It assumes we live in a zero-sum world. If Mexico benefits from NAFTA by achieving higher employment, it must necessarily come at the cost of US employment. This is utterly incorrect. Economic history makes clear that periods of the greatest *global* growth come when international trade is increasing, not contracting. By trading goods in which a country has a relative comparative advantage producing for other goods another country has a relative comparative advantage producing, the total economic pie **for each country** is expanded; both "win."

There are three specific risks posed by Trump's proposed move towards greater autarky worth highlighting. First, imposing a border tax or tariffs on cheaper imported goods lower the standard of living in the US. While cheaper foreign goods may make it harder for specific industries to compete, they present a massive boon to US consumers. Having imported clothing cost substantially less than what domestic manufacturers could produce means that American consumers have been able to afford a higher standard of living than what would otherwise have been the case.

Second, greater protectionism will be inherently inflationary. The extremely low headline CPI inflation over the last twenty years is largely attributable to cheap imported goods. As imports become considerably more expensive, this will feed through to greater inflation, which will in turn place even greater pressure on the Federal Reserve to raise interest rates.

Third, even if Trump were correct and free trade and globalization were disadvantageous to the US, he risks starting global trade wars that would do far greater damage to the US economy. Over eighty years ago two well-meaning congressmen sponsored a bill to protect vulnerable US workers from the evils of cheap imported goods. The Smoot-Hawley Act of 1930 raised tariffs on over 20,000 imported goods and would start the most destructive international trade war in history. In the assessment of the vast majority of economic historians, this plunged the world into a far greater depression than would have otherwise occurred.

In my mind, international trade is akin to the prisoner's dilemma. For those unfamiliar with this popular game theory scenario (or that may need a reminder), imagine two cohorts in a burglary caught in the act. They are each given a choice. They can remain silent (cooperate with each other), in which case both will be charged with a lesser crime and receive a year in prison. Alternatively, each of them could "defect" in which case there are two possible outcomes. In the event the other person remains silent the defector would receive no sentence while his cohort would get three years in prison. However, if they both defect and provide testimony against one another, they will each receive two years in prison. One can see that if both parties are cooperating, even though the outcome is suboptimal for each of them (a year in prison), it is a better outcome than if they both defected (double the sentence). So *even if* Trump sincerely believes that international trade is a zero-sum game (to which I strenuously take issue), it is likely both irrational and detrimental to US economic interests to impose trade barriers against nations such as China, Mexico, Germany and Canada. Protectionist actions against any or all of these nations will most certainly meet with commensurate measures from the impacted countries, thereby leading to a contraction in both global trade and economic activity, which would hurt all nations.

Concerning immigration, Trump also manifests a zero-sum outlook. According to NBC News, leaked documents concerning proposed legislation backed by Trump would reduce **legal** immigration by 500,000 people per year, or effectively one-half. Rather than seeing legal immigrants as potentially valuable human capital who would help *create* wealth and prosperity, Trump sees them as taking jobs from American citizens.[2] I suppose Trump should be grateful that Grover Cleveland did not advocate similar policies on immigration when his grandfather came to the US from Germany in 1885 as an unskilled teenager.

7. Ideological Coherence, and the Lack Thereof

On two occasions as a high school student, I had the opportunity to go to the White House and meet Ronald Reagan as a result of winning a couple of leadership scholarships. Now this was far from a prolonged personal exchange. Nevertheless I was able to hear him speak, shake his hand and exchange a few words. I remember being struck by his sincerity and vision. He famously quipped, "the nine most terrifying words in the English language are, 'I'm from the government and I'm here to help.'" He also clearly believed that individual freedom and security around the world were imperiled by the continued existence of Soviet communism. These two guiding principles — reducing the extension of government into peoples' lives and winning the Cold War — drove most of Reagan's policy initiatives. Moreover, these had been his consistent views since the early 1950's.

Donald Trump has had virtually no consistent political views outside of opposing free trade.[3] After he first explored the idea of running for president as a Republican in 1992, he launched a failed run to be the independent Reform Party candidate in 2000. The following year he registered as a Democrat, which he remained until 2009, whereupon he switched back to the Republican party. Apparently that did not take, as he registered once again as an independent in 2011. But in 2012 he had his 5th change of heart and re-registered for the third time as a Republican. But Trump was already on the record as having stated that, "I probably identify more as a Democrat." In sum, Trump seems to stand more for himself as opposed to any semblance of a coherent ideology. While this may not be a wholly uncommon characteristic among US citizens, the uncertainty it engenders can be decidedly more troubling and impactful when the person displaying it is the leader of the country. It also makes predicting exactly what Trump will do as president very problematic.

8. Their View of Themselves and the US

Ronald Reagan as president largely wanted to disappear when it came to domestic policies. As the very top of the federal government hierarchy, Reagan's aforementioned ideological views inspired him to minimize the extent to which he and other government actors intruded upon the economic lives of citizens. He believed that by reducing government's influence in this manner, it would largely unshackle the inherent dynamism of the US economy and catalyze Americans to achieve greater things. Reagan was an inveterate optimist and believed that by beating back the incursion of the state Leviathan, it would create "Morning in America."

Trump has depicted a dystopic America for his base, one in which they are under siege by domestic threats from immigrants and refugees, a liberal media establishment hostile to American values and disseminators of "fake news," and political/socio-economic elites who keep them impoverished.

Now, I must admit that I am sympathetic to some of these criticisms. I have written at length about the appalling level of socio-economic inequality, with the rich-poor gap expanding to its worst levels since the Harding administration almost 100 years ago. Also, I think most mainstream news does have a liberal bias (although I think it, in general, has been remarkably rigorous in researching and fact-checking their pieces critical of Donald Trump). But Trump's criticisms go beyond that for which there is

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[2] Facebook and numerous other high-tech companies relying heavily upon employing highly educated legal immigrants are reportedly among those who would be hurt the most.
[3] Although even here one could argue he has not been consistent. While denouncing free trade as hurting domestic industry as a potential politician, he has seen fit to take advantage of it as a businessman, regularly bypassing domestic producers in favor of cheaper imported goods.

sound evidence. Worse still, and diametrically opposite to Reagan, he is setting himself up as *the only one* who can rid America of the evils that plague it. I do not make the following assertion lightly. Trump has a messianic complex such that I have little doubt that he would like to fashion himself as a benevolent despot if he could. Repeatedly during the campaign, he asserted that, no matter what the problem (terrorism, trade, tax policies, the economy, military strategy, etc.), he both knew more than anyone else and was uniquely able to solve said problem. This messianic complex is nearly as comical as it is delusional. Witness his speech in front of the CIA's Memorial Wall the day after his inauguration. According to Trump, "God looked down and, and he said we're not going to let it rain on your speech ... The truth is it stopped immediately." According to the Washington Post, it continued to rain throughout much of Donald Trump's speech.

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9. Welcome to a Post-Truth World

As Hannah Arendt has observed, "Truthfulness has never been counted among the political virtues, and lies have always been regarded as justifiable tools in political dealings." I thus do not wish to paint a picture of politicians before Trump as being virtuous devotees to honesty. Nevertheless, with Trump we seemingly find a politician who does not just have an arm's distance relationship with the truth, but seems to be estranged from it as a concept.

The Oxford Dictionaries declared "post-truth" as its international word of the year in 2016. What exactly is "post-truth?" It is "relating to or denoting circumstances in which objective facts are less influential in shaping public opinion than appeals to emotion and personal belief." According to Politico, while campaigning, Trump issued a falsehood about once every 3 minutes and fifteen seconds! Just this week Trump charged that the mainstream media were propagators of "fake news" when several media outlets reported the results of scientifically and statistically sound polling showing that he has both the lowest approval rating and the highest disapproval rating of any incoming president since polling began. Before that, Trump has repeatedly asserted his outrageous and baseless claim that the only reason he lost the popular vote was that 3-5 million people illegally voted for Hillary Clinton.

Why should investors care about what some would consider personal foibles of Trump as an individual at best, or *ad hominem* attacks on our Commander-in-Chief at worst? Taken together I would argue they have the following import. First, Trump is unpredictable, and markets hate uncertainty. Second, Trump's belief that the world and international relationships are largely a zero-sum game (hence his disdain for free-trade) coupled with his willingness to act brazenly, will likely heighten tensions with allies and rivals alike. We have seen countries as disparate as China, Germany and Australia become rankled by Trump's imperious and adversarial manner. An increased probability of conflict, whether economic, military or both, should be expected under a Trump administration. Financial markets will not welcome this. Third, Trump's continued willingness to disregard facts while making emotional, if baseless, claims regarding the need for extraordinary actions (and presidential authority?) to defeat amorphous threats and enemies will create an environment in which it will be difficult for dispassionate and rigorous analysis to dictate US policy-making. This will be a sub-optimal environment for healthy economic growth and financial market stability.

II. What is an Investor to Do?

Let me attempt to distill the practical import for investors of the distinctions that are readily apparent between Reagan and Trump; why markets may be mispricing assets in a way that may create unpleasant surprises; and finally, what opportunities for profit may exist.

The differences between Reagan and Trump fall into three broad categories. The first, and by far the most important, represents the economic and financial circumstances each of them inherited. Reagan had the good fortune of becoming president when asset prices were cheap. The Fed was headed by a courageous chairman who was not afraid to take away the punch bowl to serve the longer-term economic interests of the nation. Debt levels across all segments of the economy were fairly light (particularly as interest rates would decline steadily for most of the next thirty-five years). Lots of slack and underutilized capital were available to be deployed. Finally, greater globalism in the 1980s would stimulate economic growth around the world for years to come.

Trump, by way of comparison, is assuming power when US stock prices are between 3-5 times more expensive based on sound valuation metrics. Interest rates reached their logical limits, or certainly came quite close to them, last summer, and the Fed is at least representing it will hike rates several times in 2017. The Fed is chaired by the third individual in a row who has both through words and deeds made it clear that her priority is to keep asset prices elevated, even at the risk of inflating serial financial bubbles. Debt levels both domestically and internationally have hit record highs as a percent of domestic and global GDP, respectively. Indeed according to the Bank for International Settlements, $57 trillion in new debt was created between the peak of the credit "bubble" in 2008 and the end of 2014, with another $15+ trillion likely added since then. Unemployment is at an eight-year low, indicating very little if any slack in the economy, while US productivity rates continue to be quite low as corporate America has consciously eschewed investment; neither of these realities are conducive to fostering non-inflationary economic growth or an expectation of corporate profit expansion. Finally, even before Trump took office, globalization was on the wane. Brexit occurred in June of last year, with several other EU countries containing political movements advocating exit from the common market as well. Moreover, as Marc Faber has pointed out, global trade has recently fallen to 2014 levels, making it the first non-recessionary decline in global trade over the last twenty-five years.

John Hussman has quite persuasively demonstrated starting valuation levels determine the vast majority of 10-12 year returns for equity investors. This bodes extremely poorly for holders and purchasers of US stocks, regardless of who occupies the White House. But nearly every other economic and financial element Trump is inheriting also creates headwinds, making it a truly daunting investment environment going forward, particularly for risky assets that have outperformed for almost eight years.

The second broad category of why 2017 is unlikely to mirror 1981 is the discretionary policies Trump intends to pursue. The anticipated salutary effects of deregulation, tax cuts and fiscal stimulus have garnered the vast majority of attention from US financial markets, as stocks rally to all-time highs and volatility remains at absurdly low levels. What is less appreciated is that the combination of tax cuts and spending increases would further escalate federal debt levels that have already exceeded 105% of GDP. Furthermore, deficit spending will reduce aggregate savings in the US, which serves as the basis for already anemic domestic investment. Also less appreciated is that while Trump's moves to limit the flow of goods and people into the US may benefit a small segment of the US population (domestic producers and people employed therein), it will create a *de facto* tax on all US consumers. This will necessarily reduce standards of living, while simultaneously creating inflationary pressures at a time when the Fed is already in a tightening cycle. Net-net Trump's policies may do as much, or more, economic harm than good. This is particularly true should Trump start an international trade war, in which case virtually all economies will suffer.

The third category of distinctions between Reagan and Trump relates to them as individuals. The point here is not to cast stones or sling mud. I would argue that there has never been a modern president whose personal characteristics, demeanor and temperament have been of greater relevance to financial markets than Donald Trump. Having observed, studied and analyzed the words and deeds of Trump with great interest, I will

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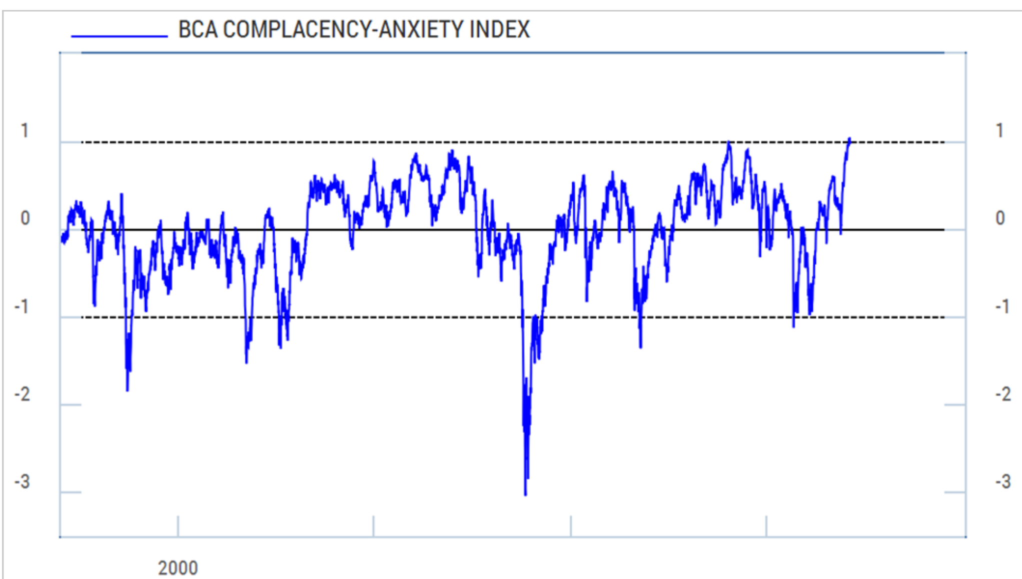
offer a few observations. While at first blush my words might appear to be unduly harsh and personal, I have chosen them with great care, and only include them due to their relevance to my point about expectations for financial markets. Trump exhibits the behavior of a petulant, venal, unrepentant, reckless, spiteful, egomaniacal, thin-skinned bully who is either a pathological liar or alarmingly self-delusional (likely both). Keith Olbermann may have said it best when tackling Trump's feud with "fake news" outlets saying, "Trump is not running a war with the media, but with reality."

Trump's personal traits have a couple of direct implications for financial markets. To begin with, as Doug Noland recently observed, markets crave predictability and certainty. Trump, who has no ideological tethering and has consistently surprised allies and foes alike, is not someone whose actions can be easily divined. He built his entire media image around what appears to be a genuine tendency to be imperious and accountable to no one but himself. This reality does not appear to jibe with a financial backdrop in which complacency, according to a new metric by Bank Credit Analysts, has not been higher over the last twenty years (*see* Exhibit 5). Future unexpected and unwelcome events concerning a Trump presidency are not being priced into the markets at all.

"It would ... appear that all of the good news concerning a Trump presidency has been discounted by the markets, with nary a concern about any downside."

Even more troublesome is his willingness to engage in extremely confrontational, careless and frequently factually incorrect rhetoric which may imperil geopolitical stability. Even before taking office Trump managed to set off the Chinese by talking directly to Tsai Ing-wen, Taiwan's president, in violation of America's long-standing One China policy. On the campaign trail, Trump often used menacing language concerning the use of force against American enemies. As noted above, given Trump's bi-modal view of the world, it is conceivable that the number of perceived enemies might mushroom significantly. The prospect of further military entanglements, particularly a conflagration with China,[4] could send financial markets into a tailspin.

Exhibit 5. Market Complacency is at Twenty Year Highs



Source: BCA Research, Inc.

[4] Just this week CNN reported that US and Chinese military aircraft had an "unsafe" encounter.

So where does all of this leave a prudent investor? US equity markets are up around 8% since Trump was elected while volatility, as measured by the VIX, has fallen by almost 45%. It would thus certainly appear that all of the good news concerning a Trump presidency has been discounted by the markets, with nary a concern about any downside.

The hallmark of great investing comes down to sound risk-reward analysis. A century of market history demonstrates that when markets have been this overvalued, 10-12 year returns have, without exception, been abysmal. Could markets go yet higher in the short-term as Trump euphoria continues? I am sure they could. But for long-term investors, this is a dangerous game to play. The first drops in financial markets are often categorized as "dips" and heralded as great buying opportunities. When losses become more pronounced, retail investors (and many if not most professional money managers) tend to hunker down, thinking that they will just wait for the inevitable short-term rebound, which would provide a more favorable exit. It is only when losses become catastrophic (think dotcom bust and the depths of the GFC) that most retail investors capitulate and throw in the towel. A far better approach for a long-term investor, and one repeatedly advocated here, is to avoid, or at least significantly underweight, expensive assets. Financial history has been far kinder to investors who may have missed the final "blow-off" stages of a bubble by exiting early than those investors driven by greed who convince themselves that outrageous valuations are somehow justified and expect markets to go still higher.

I recommend a truly diversified portfolio for investors. There are very few asset classes that look attractive from a valuation standpoint. As such, portfolio concentration is less compelling than in instances where certain asset classes offer extremely attractive risk-reward characteristics.

Alternative Assets: 20-25% allocation. In a world where most traditional assets look poised to disappoint investors, at least until there is a major equity unwinding that would return some semblance of prospective value to investors, having a decent weighting in alternative assets, which tend to have low or negative correlations to traditional assets, makes sense. Of course I am partial to currency investing for a couple of reasons. First, blow-off stages of financial bubbles are the most hostile environment in which to operate a value-based, strategic currency strategy because little attention is paid to value as people are inclined to purchase risky, high-flying assets indiscriminately. However, markets tend to adjust quite dramatically once bubbles unwind. Second, there is growing recognition that efforts by central banks to normalize the global economy through monetary intervention have been largely ineffective. Despite the perpetual expectation that "next year" will be the time when near-zero and even negative central bank lending rates can be done away with, the world economy remains incredibly fragile, subsumed by debt, and dependent upon artificially low interest rates. As financial markets continue to gradually realize that central bankers are more akin to feeble old men and women futilely pulling levers behind a curtain rather than omnipotent financial wizards, currency valuations should move more in line with fundamentals and deviation from fair value.

Precious Metals and Miners: 20-25% allocation. I have made the argument for owning precious metals and miners for a couple of years now. It is one of the few asset classes trading at fairly modest valuations. Mining stocks in particular, despite having risen in the 20-50% range over the last couple of years, are still very cheap by historical standards. But there are two other compelling reasons to consider precious metals. First, with central banks around the world targeting higher inflation, should they let the inflation genie out of the bottle and find themselves with too much of a good thing, precious metals would likely benefit. Second, owning gold in particular seems like an attractive proposition because, as highlighted above, markets are pricing in virtually no chance of downside volatility and are riddled with complacency. But with the most unpredictable president in modern history, the odds of an unwelcome surprise either economically or geopolitically

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seem quite elevated. Gold is the ultimate safe haven asset.

Stocks: 15-20% allocation, with 80% allocated to foreign stocks, and a further significant bias towards value over growth. As I argue above, investors with a longer-term time horizon are likely to receive dismal returns on US equities. There are few markets that are cheap, and all markets would be susceptible to large losses in the event of a broad global financial meltdown. Accordingly, my recommended equity allocation is significantly below what would be the case were valuations at even historically average levels. However, some foreign markets look appreciably more attractive than the US from a valuation level. These include China, Emerging Europe, Russia, Singapore, South Korea and Spain. Of course none of these markets are without their warts, but modest valuations provide investors with a margin of safety.

Bonds: 7–13% allocation. Given that most interest rates are still near all-time lows, it is hard to get excited about the prospects for fixed income investing. Generally speaking those bonds available that offer a decent yield have far too much principal risk in my eyes to make the extra income attractive from a risk-reward standpoint. High yield (junk) corporate debt and sovereign debt of emerging markets with already high debt levels, irresponsible central banks, high inflation, or some combination thereof, come to mind (Brazil, South Africa and Turkey are all good examples). Nevertheless, along with gold, US bonds are classic safe-haven assets that should perform very well should we have another global financial crisis, particularly those with a longer duration. For the adventurous, investors may consider a small allocation towards Russian sovereign bonds. Domestic inflation has come down dramatically, leaving real interest rates in Russia among the highest in the world. The central bank thus appears to have ample leeway to reduce rates (driving bond prices higher) in the coming months and even years.

Real Estate: 15-20% allocation. Real estate is always a good diversification tool for investor portfolios. Obviously most people with substantial equity in their homes have even more than this allocation. But for those high net worth individuals who under-consume on their primary residence, diversification outside the real estate market of their home country is a wise idea (especially for those living in Australia, Canada, Hong Kong and Sweden, whose housing markets all look in danger of deflating). I am partial to Singaporean REITs and have held a few in my personal portfolio for several years now. Many Singaporean REITs spin off a decent yield.

Cash: 10% allocation. In a zero interest rate world, it may be difficult to get excited about hoarding cash. Nevertheless having dry powder to deploy in the event of a major market disruption can make a huge difference. I have noted before that between December 2008 and early March 2009, a fire sale on all kinds of assets was in progress. However, the vast majority of investors who recognized the opportunity, lacked the capital to deploy due to the catastrophic losses most endured in the preceding months.

Let me end with addressing the fact that since I initially raised the prospect of what I believed to be the high likelihood of a reasonably imminent market meltdown at the beginning of 2015, not only have my concerns failed to materialize, but our fund's returns have been essentially flat from the beginning of 2015 to the beginning of 2017. Towards the middle of last year, I recognized that this bubble was fundamentally different from any other in history, even the most recent ones of 2000 and 2007. Historically, once bubbles reached egregious valuation levels and peaked, it was a matter of months before they collapsed upon themselves. It was thus profitable to be prospectively defensive, as any losses incurred while waiting would be relatively ephemeral and the profits gained by the unwinding would dwarf them anyway. This financial bubble has proved to be different. Despite US equity markets beginning a sideways drift more than two years ago, the combination of zero interest rate policies (ZIRP) by central banks and the trillions of dollars used to liquefy global financial markets through global quantitative easing (QE) programs was able to keep financial markets in a prolonged and elevated state of levitation. Upon recognizing this, we have since adapted our macroeconomic overlay to refrain from adopting a "hard defensive" posture in the fund unless and until there are some reliable signs of market distress. We thought Trump's election was the potential catalyst for such a market downturn. This did not prove to be the case.

I am sure for many if not most investors it is easier to discount the preceding analysis about the heightened risk of serious declines in "risk-on" assets now that markets have been resilient for over two years. But using a historically informed outlook on the future longer-term direction of markets has been vindicated in each and every single instance in which valuations have been stretched to either extreme for at least one-hundred years. Markets have *always* reverted to the mean.

The best comparison I can think of is earthquake insurance. There is a fault line called the Hayward Fault running beneath Oakland, Freemont and Berkley in Northern California. While lesser known, many geologists consider it to be the most dangerous fault line in the US. There has not been a major earthquake along that fault line in almost 150 years. Now a geologically uninformed homeowner in Oakland may discover this and immediately disregard the threat, reasoning that the extreme duration since there has been a significant seismic event *proves* there is no significant risk of catastrophe. The exact opposite is true of course. The pressure between the tectonic plates has been consistently building during the last 150 years. So much so that the Working Group on California Earthquake Probabilities (WGCEP), whose work is used and endorsed by the United States Geological Survey, estimates the likelihood of a 6.7 magnitude or greater earthquake along this fault line in the next thirty years to be almost **75%**!

Just like the perceived need for earthquake insurance after long periods in which no disasters occur, investors see the least danger after the longest, steepest, most unsustainable stock market ascents. And just like WGCEP, all I can do is warn people of the potential danger, in this case an economic and financial one. And similarly, while any precise prediction as to *when* a catastrophe will occur is not possible, hopefully that should not dissuade prudent individuals from taking appropriate steps to ensure that they are protected from financial harm should the anticipated calamity come to pass.

"… using a historically informed outlook on the future longer-term direction of markets has been vindicated in each and every single instance in which valuations have been stretched to either extreme … markets have always reverting to the mean."

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*** Past results are not necessarily indicative of future results. You should carefully consider whether your financial condition permits you to participate in a commodity pool. In so doing, you should be aware that commodity interest trading can quickly lead to large losses as well as gains. Such trading losses can sharply reduce the net asset value of the pool and consequently the value of your interest in the pool. References to specific securities and issuers are for illustrative purposes only and are not intended to be, and should not be interpreted as, recommendations to purchase or sell such securities.**

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About Whitmore Capital Management, LLC

Whitmore Capital Management, LLC was formed in 2012 to offer investors access to a proprietary foreign exchange investing program (the Fund, Whitmore Capital LP). This program focuses on cash currencies but may also include futures, forwards and currency options. The objective of the Fund is to achieve long-term returns superior to the Credit Suisse Hedge Fund Index.

At the very core of the investing program is a mathematical model developed by Mark Whitmore. This proprietary calculus for determining the "fair value" of exchange rates aims to identify long-term opportunities to profit from temporary currency market mispricing. The outcome of these quantitative analyses are supplemented by qualitative analyses of the circumstances surrounding each currency to determine the configuration of the portfolio itself. Finally, sentiment indicators are reviewed as an additional analytical overlay. Currencies traded for the Partnership's account may include, but are not limited to, pairs of the following currencies: AUD, BRL, CAD, CHF, CNH, CZK, DKK, EUR, GBP, HKD, HUF, ILS, JPY, MXN, NOK, NZD, PLN, RUB, SEK, SGD, TRY, USD, ZAR.

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